VZCZCXRO7047
RR RUEHAG RUEHDF RUEHIK RUEHLZ RUEHROV
DE RUEHSL #0081/01 0561302
ZNR UUUUU ZZH
R 251302Z FEB 08 ZDS
FM AMEMBASSY BRATISLAVA
TO RUEHC/SECSTATE WASHDC 1538
INFO RUCNMEM/EU MEMBER STATES COLLECTIVE
RUCPDOC/DEPT OF COMMERCE WASHDC
RUEATRS/DEPT OF TREASURY WASHDC

UNCLAS SECTION 01 OF 02 BRATISLAVA 000081

SIPDIS

C O R R E C T E D C O P Y - SENSITIVE CAPTION ADDED

SENSITIVE
SIPDIS

DEPT PASS TO USTR FOR RDRISCOLL
USDOC for 4232/ITA/MAC/EUR/MROGERS

E.O. 12958: N/A
TAGS: ECON EFIN EINV ETRD LO
SUBJECT: BOOMING ECONOMY REMAINS ON TRACK FOR EURO ADOPTION

BRATISLAVA 00000081 001.2 OF 002

¶1. (SBU) SUMMARY: Slovakia's economy continues to grow at an astronomical rate - 10.3 percent for 2007 - keeping the country on track for euro adoption in 2009. A few signs of a possibly overheating economy are present, such as creeping inflation, but these do not appear serious at this point. Prime Minister Fico appears increasingly committed to maintain sound macroeconomic fundamentals, despite occasional rhetorical flourishes to the contrary. Foreign Direct Investment levels continue to rise, and the government has approved legislation to level the playing field for domestic and foreign investors seeking investment incentives. END SUMMARY.

A VERY STRONG ECONOMY

¶2. (U) Fourth quarter and year-end statistics paint a picture of remarkable growth. Slovakia's Statistical Office estimates that the Slovak economy grew by 14.1 percent in the fourth quarter of 2007. Overall 2007 real GDP growth is projected to be 10.3 percent, which will almost certainly make Slovakia the fastest growing economy in the EU in 2007. Average real wages increased 4.2 percent to 19,600 SKK (USD 795) in the third quarter, but are still outpaced by strong productivity growth. Registered unemployment in the country fell to 7.9 percent, the lowest figure since 1996.

¶3. (SBU) Note: GDP figures for the 4th quarter are inflated due to a decision taken by the Statistical Office to include one-off excise tax intakes from cigarettes in the 4th quarter numbers. Due to an EU directive, the price of cigarettes increased as of January 2008 by 18 percent, which led to a fourth quarter 2007 pre-stocking by distribution companies equivalent to eight months of cigarette sales. The additional tax income - estimated at nearly 400 million USD -- was thus credited to the fourth quarter data. Excluding the cigarette effect, the real GDP for the quarter is 9.7 percent, which is closer to the initial estimate. The corresponding excise tax intake will be lower in the first half of 2008, which will likely lead to lower GDP growth in that period. In January 2009, a second round of cigarette tax hikes is planned, hence the real GDP growth in the final quarter of 2008 may also be artificially high. End Note.

¶4. (U) Slovakia's Maastricht fundamentals remain generally sound. The 2008 national budget forecasts a fiscal deficit of 2.5 percent. While such a deficit technically fits EU criteria, the EC gave the government's budget a lukewarm review in its January 30 evaluation of Slovakia's euro convergence plan, highlighting the need of further decreasing the fiscal deficit, adopting responsible public spending policies and continuing the implementation of structural

reforms. In response, Prime Minister Fico announced on February 16 that the government will now seek to reduce the deficit below 2 percent. Inflation rose gradually over the course of the year, and is estimated at 2.8 percent for 2007, which is below the Maastricht target.

NATIONAL BANK CONFIRMS STABILITY OF GDP GROWTH
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¶5. (SBU) Ivan Sramko, Governor of National Bank of Slovakia (The Central Bank), told Ambassador Obsitnik during a February 14 courtesy call that strong 4th quarter economic growth is not expected to lead to an overheating of the economy. He noted that growth is primarily export driven and not based on large increases in domestic consumption, which will reduce the effect on inflation. Sramko noted that Slovakia's rising inflation rate is being driven by external factors (energy and food prices) and remains within the Maastrict criteria. The Governor acknowledged, however, that sustainability of inflation is the main indicator that is being watched by Brussels before the EC makes a final decision on Euro adoption.

¶6. (SBU) Sramko expressed confidence in Prime Minister Fico's commitment to make the choices needed to keep inflation under control. He noted Fico's public rhetoric about health and social insurance policy, but said that the Prime Minister is "really very practical" and listens to the Central Bank's advice. The governor's comments were interesting since, in previous meetings, Sramko had been less willing to praise the PM directly for his role in economic policy.

FDI RISES, REGULATIONS TO BE LIBERALIZED

¶7. (SBU) The new Act on Investment Incentives, which went into effect at the beginning of 2008, simplifies the process for obtaining state aid and for the first time provides equal treatment to foreign and domestic investors. The incentives are available to varying decrees depending on the region and type of investment, with higher value-added industries and the less developed eastern and southern part of the country as the highest priorities. Ambassador Obsitnik met with Peter Hajas, CEO of The Slovak Investment and Trade Development Agency (Sario), on February 11 and underlined the

importance of transparent and more detailed regulations for potential investors, which should be approved in the beginning of
¶2008.

¶8. (SBU) Foreign Direct Investment in Slovakia remains strong, with an increasing emphasis on smaller companies (rather than large manufacturers like Kia and Peugeot). Sario reported 64 investment projects in 2007 worth SKK 42.5 billion (USD 1.9 billion) that created 14,738 new jobs. This is almost double the number of reported investments in 2006, but only a slight increase in overall investment volume. Most projects were realized in Kosice region (16), Nitra region (9), Trnava and Bratislava region (7) and in Zilina and Trencin region (7). 14 projects were realized in the machinery industry, 12 in the electromechanical industry, 10 in automotive and 7 in the chemical sector.

OBSITNIK